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March 10, 2000

The Honorable Thomas J. Bliley, Jr.
Chairman
House Committee on Commerce
2125 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Bliley:

This letter is to provide you the views of an informal coalition of six investor-owned utilities collaborating on electric transmission issues concerning H.R. 2944 as passed by the Subcommittee on Energy and Power. The six companies are CMS/Consumers Energy, Detroit Edison Company, Duke Energy Company, FirstEnergy Corp., Northern States Power Company, and Public Service Electric and Gas Company. Because our group's efforts have been confined to transmission policy, we will confine our comments to certain provisions of the bill dealing with transmission.

Let us first briefly provide background on our group. The group has been exchanging ideas for about eighteen months, but began working together in a more focused way in July, 1999. We seek to further in Congress and at the Federal Energy Regulatory Commission (FERC or the Commission) four principles for electric transmission: a market-driven and business-oriented resolution to transmission issues; the voluntary development of transmission institutions; continued flexibility of the market to determine the structure of regional transmission organizations; and encouragement for expansion of transmission investment.

We agree on these principles despite the differing status and prospective deployment of our transmission assets. One of our companies is a transmission owner in the PJM Independent System Operator (ISO) system; another has joined the Midwest ISO; three companies have received conditional approval from FERC for the Alliance, a Regional Transmission Organization (RTO) that provides, among other options, the option of a transmission owner divesting its transmission assets into an independent transmission company; and one company has been actively reviewing various options for its transmission system but has not yet committed to a particular RTO. Among our companies are some with very aggressive marketing

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affiliates - that is, companies who are both substantially invested in competing in the broad competitive markets you and we hope will more fully develop, and motivated to ensure a healthy transmission grid. Some on Capitol Hill attempt to ascribe anti-competitive motives to segments of our industry, so we mention these points to demonstrate by our actions, not just our words, that we are committed to competition.

As the movement toward greater competition progresses, the opportunities for an entirely new industry - the investor-owned, for-profit electric transmission industry - become increasingly clear. With a clear signal that Congress wants the option for these new businesses to develop as businesses and not only as quasi-public agencies, the disaggregation of today's vertically-integrated electric utilities will open the door to a new wires industry separated from electric generation. Such an industry, if not subjected to overly burdensome federal regulation going forward, could have financial incentives that will promote even more vigorous competition for power sales and better service for electric customers. As examples that industry participants see these opportunities, we need only point to the for-profit wires business some of our members are seeking to develop, or to the announcement just recently of another stand-alone transmission company attracting the help of a major equipment manufacturer with the apparent encouragement of the investment community.

A business-oriented transmission industry will expand and maintain the network, provide new services and respond to market needs. This industry holds promise only if the regulatory terms under which it exists allow the flexibility to adapt to market demands, and the ability to return profit to shareholders. By contrast, if transmission assets are forced into an inflexible regulatory regime and into the hands of entities that do not have the incentive to respond to market needs, there is risk of system atrophy, and innovation, competition and consumers will suffer.

We support legislation that would advance our principles. Therefore, we support the transmission provisions of H.R. 2944 as outlined below. We have also endorsed H.R. 2786, co-sponsored by Representatives Sawyer and Burr, among others, which is very similar in many respects to the subcommittee bill. However, we oppose legislative and regulatory action that is contrary to our principles. Proposals to give the FERC more power to design or mandate participation in RTOs, the authority to review dispositions of generation property, or the authority to address alleged market power, especially through new authority to require utilities to sell generation or transmission assets - are squarely at odds with our principles, and with the interests of consumers.

RTO Formation

We first wish to praise H.R. 2944 for what it does not do, which is mandate the formation of regional transmission organizations (RTOs). It would seem that the idea of mandating RTO participation has been put to rest. First, market activity and FERC policy as reflected in Order No. 2000 show that RTOs should, can and, given the right regulatory treatment, will form

voluntarily; and, second, the subcommittee-passed bill and Senator Murkowski's draft legislation, as well as all other major pieces of federal legislation with the exception of the Clinton Administration's bill and the one offered by Representatives Markey and Largent have declined to mandate RTO participation. This is an important and beneficial progression in the debate. RTO formation will have important benefits for consumers and the marketplace, but the obtrusiveness of a mandate and the offense to private property rights of a mandate is not justified in light of other available options.

H.R. 2944 encourages RTO formation while limiting the amount of new authority given to the FERC to encourage and oversee the processes of RTO formation. We think RTO formation is useful to foster creation of regional electric markets, so we support the bill's goal of encouraging RTO formation. We also firmly believe that FERC authority essentially to renegotiate the details of agreements between those who are forming RTOs will discourage RTO formation. Although, as outlined below, we would have preferred the subcommittee to adopt provisions such as are contained in the Sawyer-Burr bill to clarify that the FERC lacks authority under current law to mandate RTO formation, we are pleased that the subcommittee did not adopt a new mandate.

More specifically, we support the provisions added during the subcommittee markup that limit FERC from denying applications that meet certain minimum RTO standards; requiring utilities who are already in an RTO to participate in a different RTO; or setting terms or conditions for RTO membership different from those in an RTO application without giving a utility the opportunity to withdraw. We think it is very important for utilities to be able to respond to future marketplace demands by forming new RTOs with a minimum of FERC intervention.

A shortcoming of the bill is that despite very notably refusing to mandate RTO participation, it continues to allow FERC the authority to condition the approval of applications on the applicant's agreement to join an RTO. Therefore, what Congress refuses to allow FERC to do directly it still may do indirectly. We recommend an express statutory statement that FERC does not have authority to set RTO participation as a condition of approval of applications, such as a provision like the one in section 7 of H.R. 2786, which provides that no FERC order "shall be conditioned upon or require a transmitting utility to transfer operational control of jurisdictional facilities to an independent system operator or other regional transmission organization." If the formation of a particular RTO benefits shareholders and consumers, both of which groups are in the care of FERC, applicants will reach this conclusion without it being forced upon them.

A final point to emphasize with respect to the RTO provisions is that Congress must recognize the financial imperatives facing the industry. The terms of RTO formation must be dictated by marketplace demands, rather than by government, or capital will flow to other investment options. Consider the difficulty of attracting investment for construction of new infrastructure the operation of which is not in the company's control and is instead in the hands

of a non-profit entity with a set of ill-defined political goals to pursue.

Transmission Pricing

We support the transmission pricing provisions of H.R. 2944. We believe the Sawyer amendment, adopted without opposition by voice vote at the subcommittee markup, markedly strengthens the bill and buoys its goal of broadening competition.

The gap between the transmission needs of growing regional electric markets and the amount of new transmission construction is widening. One of the fundamental reasons is that the return on investment for transmission is simply not commensurate with other investments of similar risk. H.R. 2944 as adopted by the subcommittee addresses this problem. Some policymakers have assumed that regional markets will grow only if the cost of transmission goes down, because competitors further away from the market would be able to economically get their power to the market. This misses a fundamental point, which is that there is currently not enough transmission capacity to sustain the kind of regional markets envisioned, and no one is going to invest in new capacity without assurances of adequate returns. Wall Street utility investment experts have been outspoken in pressing this point.

FERC has ample discretion today under the Federal Power Act to reform its pricing policies. In fact, it has a legal obligation to ensure that rates of return adequately compensate investors for risks taken and are comparable to rates of return earned in other industries. However, approved transmission rates have lagged substantially. This is a problem the importance of which will grow in the utility industry as competitive markets develop and more transactions become subject to FERC jurisdiction.

Section 105(b) of the bill adds a new section 217 to the Federal Power Act (FPA), setting forth clear standards for the Commission in establishing transmission rates, with the goal of facilitating expansion of transmission facilities. The bill maintains the traditional rate making requirements in FPA sections 205 and 206; thus section 217 is to be read in addition to, rather than in place of, existing requirements.

Subsection (a) of the new section 217 directs FERC to permit transmitting utilities to recover transmission costs incurred by the utility, including the cost of enlargement of transmission facilities. This provision is clearly to be read in conjunction with the requirements of subsection (c), which reiterates the "just and reasonable" standard in section 205, and adds a requirement that transmission rates also promote economically efficient transmission, transmission expansion, and the introduction of new technologies. Subsection (b) requires FERC to take into account the incremental cost and benefit of new transmission facilities when setting transmission rates for RTOs.

New section 217 also includes provisions requiring FERC to encourage the voluntary filing of innovative pricing policies by transmitting utilities to promote voluntary participation in

RTOs, minimize cost shifting among customers, encourage efficient and reliable grid operation through congestion management, performance-based or incentive rate making, and encourage investment in and expansion of the transmission facilities of an RTO. We think it is a very positive signal that both the FERC, through Order No. 2000, and the Congress, through the only electric restructuring bill on which a vote has been held, have committed to encouraging innovative or incentive pricing. At least in concept, incentive pricing has reached the status of a non-controversial issue in the restructuring debate, which in itself, even without enactment of legislation, is an important boon to transmission investment and competition.

The transmission pricing provisions also authorize but do not require FERC to approve negotiated rates where transmission users and transmission providers can reach agreement. We believe the Commission has authority to authorize negotiated rates today, but this provision will encourage FERC to use the authority.

Finally, the transmission pricing provisions authorize but do not require FERC to permit market-based transmission rates where it finds that relevant geographic and product markets for transmission services or for delivered wholesale power are subject to effective competition. This is a forward-thinking provision. We believe the Commission also has the authority to authorize market-based transmission rates, but this provision will encourage their consideration. Not too many years ago, industry experts would have dismissed the notion of retail competition in electric generation, and today such competition exists. Experts today are losing their skepticism about competition in electric transmission. In fact, because of generation competition, transmission competition is more likely to develop, because transmission of power is a substitute for generation closer to the load and an entire new class of electric markets and customers is forming. This provision is an opportunity for the Committee to demonstrate the next level of vision on competition by highlighting that the relevant market frequently is the one for delivered power.

Merger Review Authority

We think that FERC reviews of dispositions of property under section 203 of the Federal Power Act take far too long and are duplicative of reviews conducted by other agencies. For some transactions, review is required by FERC, the Department of Justice, the Federal Trade Commission, the Securities and Exchange Commission, the Nuclear Regulatory Commission, and each affected State. We do not quarrel with utility transactions being reviewed by government and we agree that there are important societal and governmental interests to be protected. However, the massive, time-consuming, duplicative review specific to the utility industry is contrary to consumer interests because it delays companies' ability to respond to market needs and needlessly increases transaction costs. It also invites industry participants to press for concessions on all manner of issues that can and should be addressed in other forums in exchange for dropping or limiting their opposition to a proposed transaction. We recommend eliminating or streamlining FERC review under section 203.

H.R. 2944 includes a provision adopted by the subcommittee and offered by Representative Burr which amends section 203 so that FERC's authority to review a section 203 application expires 180 days after the application is filed. In other words, if FERC has not acted upon the application after 180 days, the statutory obligation to get the Commission's approval of the transaction expires. We think the Burr amendment is a useful provision and we support it.

In conclusion, we would like to offer you and your staff our assistance as the Committee considers electric industry restructuring legislation. Our group is unique, or at least unusual, in that the executives who operate transmission facilities regularly participate in the group and the policy debates. We are very proud of this fact, and believe it enables us to respond better to issues raised on Capitol Hill. We will gladly meet with you or your staff at your convenience to explain our positions in more detail.

Sincerely,

Pat McCormick

Fred Eames